

Trends and Tips to Improve Your Retirement Plan

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Background

- According to Investment Company Institute ...
 - 401(k) plans hold estimated \$5.0 trillion in assets (March 31, 2017)
 - Approximately 55 million workers are 401(k) participants (2015)
 - Almost 550,000 401(k) plans (2015)

Background

- DOL enforcement – FY 2016 EBSA
 - \$777 million recovered for payment to plans, participants, and beneficiaries
 - 62 federal lawsuits filed
 - 333 criminal investigations closed
 - 96 indictments
 - Does not include private civil litigation brought by plaintiffs' lawyers

Washington Update

- Fiduciary rule

- June 9, 2017 – Fiduciary rule and BICE become effective
- DOL issues “Transition BICE” rules for June 9, 2017 to December 31, 2017
- DOL has proposed that Transition BICE be extended through July 1, 2019
- DOL has adopted a “non-enforcement” policy
- Industry in “wait and see” mode

Washington Update

- Fiduciary rule (Cont.)
 - 1975: Initial regulation
 - ❖ Before participant-directed 401(k) plans
 - Today: Participant-directed 401(k) plans
 - Today: Widespread use of IRAs
 - Today: Common practice to roll over ERISA-protected plan assets to IRAs not protected by ERISA

Washington Update

- Fiduciary rule (Cont.)
 - DOL concerned that “investment advisers” can act with conflicts of interest
 - Imprudent and disloyal advice based on adviser’s needs (not participant’s needs)

Washington Update

- Fiduciary rule (Cont.)
 - Person who provides investment advice to plan (or participant) or IRA (or IRA owner) for a fee or compensation (direct or indirect) with respect to monies or other plan/IRA property
 - ❖ Advice means recommendation of buying, holding, selling, exchanging securities or other investment property (“assets”) or recommendation as to how assets are invested after assets are rolled over, transferred, or distributed from plan/IRA

Washington Update

- Fiduciary rule (Cont.)
 - Recommendations on rollovers, transfers, or distributions from plan/IRA
 - ❖ Whether to roll over, transfer, or distribute
 - ❖ Amount, form, or destination
 - Recommending a rollover is a fiduciary act
 - “You should not take a distribution” is a fiduciary act

Washington Update

- Fiduciary rule (Cont.)
 - Participant education is not investment advice
 - ❖ Plan information
 - ❖ General financial, investment, and retirement information
 - ❖ Asset allocation models
 - ❖ Interactive investment materials

Washington Update

- Best Interest Contract Exemption (“BICE” or “BIC Exemption”)
 - “Transition BICE” expected to apply until at least July 1, 2019
 - Only way for investment advisor to receive variable compensation or payments from third parties

Washington Update

- BICE (Cont.)
 - Transition BICE
 - ❖ Best interest of investor
 - ◆ Duty of prudence
 - ◆ Duty of loyalty
 - ❖ Reasonable compensation
 - ❖ No misleading statements

Washington Update

- Fiduciary rule and BICE action items
 - Ask service provider how DOL guidance affects services to plan
 - Review websites and participant education materials to ensure they constitute education and not advice
 - Keep current on status of fiduciary rule and BICE

Washington Update

- Intriguing ideas
 - Matching contributions based on student loan payments for participants who cannot afford to make 401(k) contributions
 - Eliminate required minimum distributions or delay required beginning date, for example, to age 80

Washington Update

- Intriguing ideas (Cont.)
 - “HSA Side Car”
 - ❖ Add HSA to 401(k) plan
 - ❖ HSA participants get access to lower cost investments available under 401(k) plan
 - ❖ Access to “holistic” financial education and planning across health and retirement accounts
 - ❖ Idea is to create more and better invested HSA accounts

Washington Update

■ Tax reform

- Moving forward . . . But can Republicans agree on legislation?
- Pre-tax contributions seen as gigantic tax expenditure – aka “loophole”
 - ❖ Issue seen through 10-year budget window
 - ❖ Argument discounts that distributions will ultimately be taxed . . . Not like other deductions that are never recaptured
- Potential decrease in contribution limits

Washington Update

- Tax reform (Cont.)
 - Potential “Rothification” of 401(k) plans
 - ❖ Eliminate pre-tax deferrals
 - ❖ One way to pay for individual and corporate tax breaks
 - ❖ Concern about effect on worker retirement savings
 - ❖ Expect retirement industry to fight Rothification . . .
Industry sees this issue as the “sky falling”
 - ❖ Split-the-baby solution . . . Rothification for high income taxpayers only?
 - \$2,400 annual cap on pre-tax deferrals
 - ❖ Additional deferrals would be Roth deferrals

Audit

- Audit triggers
 - 5500 information
 - ❖ Late filing
 - ❖ Incomplete or inconsistent forms or schedules for current year and year-to-year
 - ❖ Timely deposit of deferrals and loan payments
 - ❖ Hard-to-value assets
 - ❖ Fees – Schedule C – Large plan filers
 - Participant complaints

DOL Audit Focus

- Late deferrals and loan payments
- Excessive service provider fees
- Imprudent investment menu
 - Imprudent investments
 - Investments too expensive
- Hard-to-value assets
- Lost participants

IRS Audit Focus

- Plan document issues
- Employee eligibility
- Contributions – Using correct “compensation”
- Vesting
- Distributions
 - Termination
 - Hardship and in-service
 - Minimum distributions
- Loans
- Nondiscrimination testing

Plan Design “Red Flags”

- Pay special attention to . . .
 - Different compensation definitions based on contribution type
 - Excluding certain types of compensation
 - ❖ Bonuses
 - ❖ Overtime
 - ❖ May result in nondiscrimination testing of compensation

Plan Design “Red Flags”

- Pay special attention to . . . (Cont.)
 - Excluding employees
 - ❖ Part-time, temporary, seasonal employees
 - ❖ Exclusion based on job classification
 - ❖ Coverage testing implications
 - Multiple eligibility requirements based on contribution type
 - Rehired employees – Eligibility
 - ❖ Know when they enter plan

Plan Design “Red Flags”

- Pay special attention to . . . (Cont.)
 - Rehired employees
 - ❖ Eligibility – Know when they enter plan
 - ❖ Vesting – Know when and how prior service is credited for vesting purposes
 - ❖ If you don’t know the answers to these questions, ask your service provider
 - Administering hardship distribution provisions properly
 - Administering loan provisions properly

Self-Audit

- Deposit deferrals (and loan payments) on a timely basis
 - Small plans (≤ 100 participants)
 - ❖ 7-day safe harbor period to forward deferrals and loan payments to plan's trust
 - ❖ Deferrals do not need to be allocated to participant accounts within 7-day period – But fiduciary principles require timely allocation to accounts and investment
 - Large plans (> 100 participants)
 - ❖ As soon as practicable
 - ❖ Past practices set standard

Self-Audit

- Communicating with participants
 - Respond promptly and professionally to participant questions and requests
 - Give participants required disclosures (e.g., SPD, SMM, benefit statements, fee disclosure, etc.)
 - Develop an effective employee communications and education program
 - Provide participants with well-designed online experience

Self-Audit

- Payroll audit
 - Ensure proper deferrals are being withheld and timely forwarded to plan
 - ❖ Proper amount of deferrals
 - ❖ Proper type of deferrals – Pre-tax and/or Roth
 - Downside – You’ll probably find errors
 - Upside – At least you (and not DOL/IRS auditors) found the errors
- Comply with bonding requirement

Self-Audit

- Proper definition of “compensation” being used
 - Understand different compensation components (bonus, commissions, welfare benefits, etc.)
 - Understand plan document’s compensation definition as applied to different contribution types

Self-Audit

- Eligibility and entry dates
- Proper allocation of matching and profit sharing contributions pursuant to plan document
- Vesting
- Spot check distributions
 - Hardship, in-service, RMDs
 - Proper withholding

Self-Audit

- Review compliance testing results
- Watch out for “part time” employees
 - Employee working 1,000 hours a year is not a “part-time/seasonal/temporary” worker
- Top heavy minimum contributions
- 5500 correctly prepared and timely filed

Self-Audit

- Proper and timely disclosures made to participants
 - Summary plan description and summary(ies) of material modifications
 - Participant fee disclosure
 - QDIA notice
 - Safe harbor notice
 - Automatic enrollment notice

Tips to (Consider) to Improve Plan

- Important practice tip
 - Follow prudent process
 - ❖ Selecting and monitoring plan's investment options
 - ◆ This includes fees
 - ❖ Selecting and monitoring service providers
 - ◆ This includes fees

Tips to (Consider) to Improve Plan

- Important practice tip (Cont.)
 - Follow prudent process (Cont.)
 - ❖ Obtain information relevant to making decision
 - ❖ Evaluate the information obtained
 - ❖ Consult experts, if needed...And make a decision
(Don't blindly accept expert's decision)
 - ❖ Make decision based on information obtained and evaluated, and advice received
 - ❖ Document decision in writing and reasons for making decision
 - ❖ **PUT IT IN WRITING**

Tips to (Consider) to Improve Plan

- Important practice tip (Cont.)
 - Follow prudent process (Cont.)
 - Document minutes of investment review meeting –
At least annually (or other type of review meeting)
 - ❖ Who attended
 - ❖ Topics covered
 - ❖ Points of discussion
 - ❖ Decisions made
 - ❖ Reasons for decisions
 - ❖ **PUT IT IN WRITING**

Tips to (Consider) to Improve Plan

- No formal committee?
 - Review plan's investments at least annually
 - ❖ Includes fees, performance, etc.
 - ❖ Follow investment policy statement
 - Schedule annual meeting with service provider(s)
 - ❖ Investment review
 - ❖ "State of the Plan"
 - ❖ Document meeting in writing and keep in fiduciary file along with any reports provided by service providers

Tips to (Consider) to Improve Plan

- Fee review -- Pay only “reasonable” fees
 - Proper fees paid pursuant to written contract
 - Fees properly allocated to participants
 - Benchmark fees regularly
 - Consider sending out for RFP – Law firms and consultants recommend every 3-5 years
 - Review plan sponsor fee disclosure
 - ❖ ERISA requires fiduciary to review, understand, and evaluate fee disclosure – Ask questions

Tips to (Consider) to Improve Plan

- Why fees are important . . .
 - DOL Example 1:
 - ❖ Employee – Participant has 35 years until retirement
 - ❖ Participant has current account balance of \$25,000
 - ❖ 7% gross investment return for 35 years
 - ❖ Fees and expenses reduce return by 0.5%
 - ❖ Account balance will grow to \$227,000 at retirement

Tips to (Consider) to Improve Plan

- Why fees are important . . . (Cont.)
 - DOL Example 2:
 - ❖ Same facts as Example 1 except that fees and expenses are 1.5% (not 0.5%)
 - ❖ Account balance will grow to \$163,000 (not \$227,000) at retirement
 - ❖ This means a 1% increase in fees will reduce retirement account balance by 28%

DOL's "A Look at 401(k) Plan Fees" publication

Fiduciary Liability Insurance

- General concepts
 - Fiduciary liability insurance is not the same as the ERISA-required fidelity bond
 - Plan can purchase insurance to cover liability/loss due to act or omission by fiduciary
 - ❖ Policy must permit recourse by insurer against fiduciary
 - Employer can purchase insurance to cover potential liability of fiduciary

Fiduciary Liability Insurance

- General concepts (Cont.)
 - Possible insureds
 - ❖ Plan sponsor
 - ❖ Plan administrator
 - ❖ Committee members
 - ❖ Officers, directors, employees acting as fiduciaries
 - Duty to defend
 - ❖ Insurance carrier will defend claim against insured
 - ❖ Right to select defense counsel

Fiduciary Liability Insurance

- Read and understand your policy
 - General liability insurance or directors and officers (D&O) liability insurance often does not cover breach of fiduciary duty claims
 - Employee benefit liability insurance
 - ❖ Typically endorsement onto commercial liability policy
 - ❖ May not provide coverage for breach of fiduciary duty
 - ❖ May only provide coverage for errors in administering plan – And may be more restrictive than fiduciary liability insurance

Fiduciary Liability Insurance

- Read and understand your policy (Cont.)
 - Insurance may cover any or all of the following
 - ❖ Breach of fiduciary duty claim
 - ❖ Negligent errors and omissions
 - ❖ Costs to voluntarily bring plan into compliance with IRC and ERISA
 - ❖ Improper participant disclosures
 - ❖ Improper plan amendments
 - ❖ Imprudent investment selection/monitoring
 - ❖ Imprudent selection of service providers

Tips to (Consider) to Improve Plan

- Automatic enrollment
 - Automatically enroll participants in 401(k) portion of plan at pre-determined “default deferral rate”
 - Invest non-electing participant into qualified default investment alternative (e.g., target date fund)
 - Much more common for larger plans

Tips to (Consider) to Improve Plan

- Automatic enrollment (Cont.)
 - Vanguard's "How America Saves, 2017"
 - ❖ Vanguard plans offering automatic enrollment features have increased 300% since 2007.
 - ❖ Two-thirds of Vanguard's automatic enrollment plans include auto-escalation
 - Advantages
 - ❖ Increases participation rate
 - ❖ Leads to higher deferral rates

Tips to (Consider) to Improve Plan

- Automatic enrollment (Cont.)
 - Potential concerns
 - ❖ Will lead to increased matching contributions if plan makes matching contributions because deferral rates and plan participation will increase
 - ❖ Sometimes default rate set too low (e.g., 3%) to lead to meaningful participant retirement savings
 - ❖ Can lead to costly corrective contributions if employer does not have proper payroll processes in place

Tips to (Consider) to Improve Plan

- Automatic enrollment (Cont.)
 - Potential concerns (Cont.)
 - ❖ Employers worry about “forcing” participants into 401(k) plan
 - ❖ Can be addressed with thorough participant education campaign that lets participants
 - ◆ How automatic enrollment works – Default deferral rate and default investments
 - ◆ Explain how and when to opt out of automatic enrollment – Before or after date automatic deferrals begin

Tips to (Consider) to Improve Plan

- Automatic enrollment (Cont.)
 - Making it better . . .
 - ❖ Higher automatic deferral . . . Not just 3% . . . Studies suggest “stick” rate will not suffer
 - ◆ Gives boost to retirement readiness
 - ❖ Automatically enroll everyone . . . Not just new employees
 - ❖ Auto escalation

Tips to (Consider) to Improve Plan

■ Re-enrollment

- This is not automatic enrollment
- Concept – Sponsor defaults participant accounts into qualified default investment alternative
 - ❖ Example -- Target date fund where asset allocation becomes more conservative as participant approaches age 65
 - ❖ Helps ensure participants improve asset allocation

Tips to (Consider) to Improve Plan

■ Re-enrollment (Cont.)

- Pension Protection Act of 2006 can provide fiduciary protection to re-enrollment process
- Preserving fiduciary protection
 - ❖ Several education contacts before re-enrollment
 - ◆ Required notices
 - ◆ Group meetings
 - ◆ Follow-up communications
 - ❖ Make sure participants understand they can opt out of re-enrollment

Tips to (Consider) to Improve Plan

- Re-enrollment (Cont.)
 - Can help combat investment inertia
 - ❖ What was good five years ago may not be good today
 - ❖ QDIA choice may be helped by inertia
 - Participants may not feel strongly about investment elections – “I flipped a coin”

Tips to (Consider) to Improve Plan

- Re-enrollment (Cont.)
 - Participant may not understand their current investment elections and/or the risk associated with those investment elections
 - Can corrects poor investment choices
 - Rebalances accounts

Tips to (Consider) to Improve Plan

- Shorten eligibility requirements
 - Allows you to put retirement plan information in front of your new employee upon hire . . . Rather than a year after he/she is hired
- “Stretch Match”
 - Not \$1 for \$1 on 4% of compensation deferred
 - 50 cents on \$1 on 8% of compensation deferred
 - Goal – Increase participant deferrals at no additional cost to employer – Probably less cost

Tips to (Consider) to Improve Plan

- Robust participant education program
 - Decreases likelihood of participant frustration
 - Increases participant's retirement plan experience
- Components of robust participant education
 - Group meetings
 - One-on-one meetings
 - Newsletters
 - Webinars
 - Contemporary-looking retirement plan website
- More is better (must be quality information)

Tips to (Consider) to Improve Plan

- Participant education topics
 - How the plan works
 - ❖ Eligibility
 - ❖ Contributions and contribution requirements
 - ❖ Vesting
 - ❖ Distributions
 - Plan investments
 - ❖ Including importance of fees and performance
 - ❖ Including discussion of target date funds and glide paths
 - ❖ Asset allocation, etc.

Tips to (Consider) to Improve Plan

- Participant education topics (Cont.)
 - Targeted education (e.g., “low savers,” young participants, participants nearing retirement)
 - Retirement readiness
 - Plan’s website
 - Need to diversify -- Asset allocation
 - Discussion of investment time horizon
 - Dollar cost averaging
 - Financial wellness (e.g., budgeting, saving for college, reducing debt, managing credit, etc.)

Tips to (Consider) to Improve Plan

- Participant education topics (Cont.)
 - Impact of inflation on retirement savings
 - Explanation of concept of tax deferral
 - Explanation of differences between pre-tax deferrals and Roth deferrals
 - Concepts relating to investment risk and return characteristics
 - Concept of compound earnings
 - In-person communication – At least once a year

Questions

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